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Guaranty Trust Company of New York

The railroad situation

[New York, etc.]

1917

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The Railroad Situation

Guaranty Trust Company
of New York

The Railroad Situation

1917

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PREFACE

The Guaranty Trust Company of New York offers this booklet presenting the facts concerning the railroad situation today in recognition of the importance of the problems which now affect the railroads, and also in the belief that these problems can be solved if a better understanding concerning them is established and a sentiment for helpful co-operation created among the many interests involved.

Fully half of the population of the United States is concerned directly, and all of the population indirectly, in maintaining the efficiency and credit of our transportation system. As President Wilson has said, it is "the one common interest of our national life."

The Railroad Situation

Its Problems and their Solution

IN the various problems affecting the railroads of the United States today, the whole business organism of the country—industrial, commercial, and financial—is involved, and an understanding of these problems on the part of the general public is obviously essential to their proper solution.

Transportation enters into the life of all. The wheat fields of the far west answer the daily prayer for bread in the cities of the east, and every phase of national life is dependent in some degree upon transportation. It is to be hoped that a public knowledge of the facts concerning the situation, can and will meet the problems it presents.

In any brief discussion of the railroad

question, it is necessary to consider the transportation system of the country as a whole, because in its credit and service as a whole the entire country is concerned. That some roads are rich and some poor—that some have been better managed than others—that mistakes have been made in the past—are points that cannot be discussed in this brief analysis of the situation now faced; nor is it pertinent to discuss the principle of governmental regulation of railroads, which is accepted by the railroads and the public alike. But it is maintained that it is in the interest of all concerned that any plan of regulation adopted for these instrumentalities of commerce be made fair and efficient in the public interest, and that governmental action be based upon obvious business and public necessities.

Coöperation and Coördination

Since the first real steam railroad was built in 1828, transportation has progressed through various periods, which may be roughly divided under the headings of *construction*, *competition*, and *regulation*. The failure of the

present system to protect equally the interests of the investor, the shipper, and the public under either the past or present order, logically suggests a new period of *coöperation and coördination*, in which due consideration will be given to the interests of *all* concerned, and the elimination of inequality, waste, and inefficiency.

Public interest demands that in either the exigencies of war or the necessities of peace the railroads shall be so equipped and regulated as to most efficiently respond to the needs of the hour. The importance of efficient transportation, either as a military arm in war or an economic factor in peace, is strikingly demonstrated today.

The recent action of the railroads in vesting power in a central committee of railroad executives at Washington to direct the operation of their properties as one national transportation system to meet the war crisis marks an important step in progress, and seems to assure an increasing degree of coordinated action and regulation, even when the necessities of war no longer exist.

Indications of Reaction

On many sides there are indications that a reaction from ten years of over-regulation and railroad-baiting has set in, and a greater degree of understanding of and sympathy with the transportation problem is marked.

Critical analysis of the situation quickly reveals that railroad credit has been at a low ebb and railroad expansion has practically ceased. The transportation machine of the country has been unable to meet the increasing demands of commerce, and neither earnings nor credit are sufficient to meet the need. The situation presented is the concern of every citizen and yet it is obvious that few have really appreciated its significance.

Present Problems

Briefly, the important problems which the railroads face today may be summarized as follows:

First, REGULATION:—Ninety-five independent, uncoördinated legislative and regulating bodies, representing the federal government and the forty-eight states, are attempting to regulate the railroads to the minutest detail of their operations, increasing their burdens and expenses without provision to meet them.

Second, WAGES:—Through the imposition of the Adamson Law, instituting an 8-hour wage scale in train service, the expenses of the carriers have been increased over $60,000,000 a year to the classes of labor involved, and will be increased double that amount in meeting the demands of other classes of labor for which this example has been set.

Third, RATES:—Present freight and passenger rates are much too low to provide adequate revenues for the railroads as a whole, revenue which would enable them to meet their operating expenses and fixed charges, provide a reasonable return on the investment and a surplus to furnish credit for necessary expansion.

Fourth, COST OF SUPPLIES:—All forms of railroad supplies have increased greatly in price during the past two years, representing advances of from 50% to 500% in cost to the railroads. The coal bill alone in 1917 will be over $100,000,000 more than in 1916.

Fifth, VALUATION:—An expensive and burdensome attempt is being made by the Interstate Commerce Commission to place a value upon the physical properties of the railroads, in compliance with an act of Congress. This is forcing upon the railroads and the country an expense burden of $50,000,000, so far without adequate results.

Sixth, CAR SHORTAGE:—Through the tremendous pressure of foreign commerce, railroad equipment has been insufficient to meet the demands upon it, and after two years under constant high pressure, without adequate repairs, is losing efficiency.

Any of these problems alone is a matter of moment to railroad executives, to-day; taken together they constitute a handicap to our transportation system which demands the attention and understanding of the public, to the end that the railroads of this country may be brought to the point of highest usefulness and service to the nation.

Earnings Decreasing

There are many supporting and collateral facts bearing upon this situation which may profitably be considered. The earnings statements of the carriers for the first months of the current year are showing the effect of their attempt to continue to furnish transportation at peace prices on war costs. That the present condition which the railroads face was inevitable has been known to every student of transportation, and yet the general ignorance of and indifference to these facts have prevented their solution. Unless relief is afforded, a sharp realization of the shortsightedness of the policy which has been pursued towards the railroads during the past ten years will be increasingly evidenced.

Too firmly fixed in the public mind have been the misleading figures of the net operating income of 1916, the largest in the history of American railroads, aggregating over one billion dollars; yet this amount was less than 6% upon the value of railroad property devoted to the use of the public, and one-third or more of this figure will be wiped out by the increased operating expenses of the current year now in sight, unless rate increases are granted. When this return is compared with the returns enjoyed by capital in other enterprises, it is logical that capital should seek other channels for investment.

The Railroad Dollar

There is a limit to the resources of the carriers. They cannot pay out more than they take in, and their dollar, after all, contains only one hundred cents. Of that dollar, last year, labor received approximately 43 cents; the tax collector took 5 cents; fuel and locomotive supplies, 8 cents; other materials and supplies, 16 cents; loss and damage, 2 cents; betterments, 2 cents; leased road

rentals, 4 cents; and interest on funded debt, 15 cents, leaving for dividends and surplus barely 5 cents. The railroads must operate under the law—no matter what the result. The division of the railroad dollar is a graphic but somewhat tragic exhibit of the results of railroad regulation in the United States, a system whose tendency is to "regulate" railroad earnings ever downward and railroad expenses ever upward. Only by a tremendous increase in efficiency in train movement, accomplished by heavy expenditures, through which more tons of freight per locomotive were hauled, was disaster for the carriers avoided; and now efforts are being made, successfully, in some states, to limit train length. The item of taxes per mile of railroad alone increased from $200 in 1907 to $573 in 1914, or 186%.

Increased Railroad Expenses

The estimate of the *Railway Age Gazette* for increased railway expenses for the current calendar year, over the fiscal year ending June 30, 1916, includes the following items:

Train service employes' wages, (due to Adamson Act)	$60,000,000
Other employes' wages	40,000,000
Fuel (increase in price, 75c a ton)	100,000,000
Taxes (increase 15%)	22,000,000
Rails (3,000,000 tons, increase in price a ton $10)	30,000,000
Locomotives (3,500 at increase in price of 90%)	72,000,000
Passenger cars (3,000 at increase in price of 50%)	18,000,000
Freight cars, (175,000 at increase in price of 50%)	105,000,000
	$447,000,000

To meet these increased charges, petitions have been filed with the Interstate Commerce Commission for horizontal increases in freight rates, averaging about 15% upon the present scale, which, it is estimated, will increase revenues over $300,000,000. While some minor rate increases have been granted by the Commission, consideration of these proposed increases is being given by the Commission, and the filings of the railroads have been allowed to take effect July 1, unless denied or suspended as the result of the investigation now under way.

The plea of the railroads is that these rate increases are necessary not only to sustain their credit and to permit expansion, but also to maintain their operating efficiency. They urge that advantage to the shipper in having transportation facilities adequate to his needs, and to the nation in having railroad preparedness for any emergency, demands favorable action on these petitions.

The cost to business interests generally of freight congestion has been far more than a rate charge sufficient to maintain adequate service. Public interest clearly demands that whatever charge is necessary for the maintenance of these properties, with reasonable investment returns, shall be approved. In assuming to regulate both the income and the outgo of the carriers, the public has also assumed the burden of providing adequate transportation. If the railroads are to keep step with the commercial development of the country, they must be permitted a larger share of the country's prosperity than is reflected in present earnings.

Investment faith or confidence in railroad credit has been weakened—not because belief in the wisdom and initiative of railroad managers has declined, but because the average investor views with apprehension the arbitrary and exacting lengths to which public regulation of railroads has been stretched, and its interference with the judgment of railroad executives in regard to details of management and operation. Investors do not care to confide in a system of regulation which places a bewildering artificial limitation on the profits of the carriers, and indiscriminately adds to their cost of operation. No system of regulation can regulate railroads adequately which does not take into consideration this question of railroad credit. Service depends upon facilities, and facilities, in turn, upon credit. Weaken or remove the credit, the whole structure falls.

Subjected to heavy capital expenditures, increased taxation, burdensome regulation, constantly rising operating costs and substantial reductions in rates by numerous

States, our railroads find the sale of their stocks most difficult and even borrowing possible only at high rates.

The shrinkages in the prices of representative railroad stocks clearly indicate the loss of favor for such securities among investors, and indicate also the weakened credit of the carriers. Failing to finance their wants through sales of stock, the railroads have been compelled to raise the money they needed through the sale of bonds and notes. In other words, the railroad industry has had to transact almost all of its new business on borrowed money, which has increased fixed charges and diminished the margin of safety—the annual surplus of net income over and above fixed charges—which is the fundamental element of security and attractiveness in railroad bonds.

Funded Debt High

It is a striking fact that not a single share of new railroad stock was listed on the New York Stock Exchange or sold to the public for new railroad building last year. In broad

terms, the present debt of the railways exceeds $10,000,000,000 while their stocks amount to over $6,000,000,000. On this presentation it is clear that the railroads are pulling a laboring oar when they attempt to borrow permanently more than $10 for every $6 realized through sales of stock. Unless future railroad financing can be done more with stock and less with bonds, the financial position of the railroads must become more and more difficult, and stock can not be sold unless the credit of the railroads is maintained.

Railroad Owners Not Considered

The time has come when the business world, for its own protection, must face these questions of transportation credit and earnings. Seemingly our present system of railroad supervision gives but little consideration to the interest of stockholders and bondholders, but exercises sweeping control over railroad operation and management in what is assumed to be the interest of the shipping and travelling public. Railroad investors—the real owners of railroad properties—can-

not control the conditions under which they are operated, yet they are expected to furnish transportation in accordance with the public demand. Obviously this unfair relationship cannot be expected to continue. Either private capital must be attracted and protected or public capital must be sought. There is no inexhaustible reservoir of money to be tapped at will for railroad improvements. Dollars cannot be coerced into railroad service any more than men. They must be won.

Decreased Power of the Dollar

Sums subtracted from earnings by rate restrictions impose, in the aggregate, severe burdens on the carriers, but scarcely affect the price of a commodity to the ultimate consumer, because of their un-appreciable proportion to its cost. Thus, through reductions which they cannot prevent, the income of the railroads is substantially reduced, while the purchasing power of what they actually earn has depreciated. Owing to the 115% increase in commodity prices from 1895 to 1917, the purchasing power

of the dollar has declined from 100 to 45, or 55%. Consequently, under our existing system of regulation, the railroads are compelled to accept payment for their services today at the rate of 45 cents on the dollar, if the altered purchasing power of the dollar since 1895 is considered.

Public's Gain from Low Rates

Had transportation rates risen step by step with commodity prices, the average rate per passenger mile in 1915 would have been 2.95 cents instead of 1.98 cents, (or 50% greater); and the ton-mile freight rate would have been 1.21 cents instead of .732 cents, (or 66% greater). The differences represent a saving to the public in the single year, 1915, of $314,000,000 in passenger fares and $1,340,000,000 in freight charges, or a total of $1,654,000,000. In the twenty years from 1895 to 1915, while commodity prices were gradually rising, and all other lines of industry were enabled to adjust their charges to the prevailing economic conditions, the railroad ton-rate charge was not increased,

but as a matter of fact, actually declined, until in the present year it now stands at .707 cents, the lowest in the history of American transportation.

Moreover, freight charges on railroads in the United States are the lowest in the world, as is also their capitalization per mile. The wages paid their employes are the highest; while their operating efficiency is greatest. Yet this great transportation system, embracing over 250,000 miles of road, and representing a property value of over $17,000,000,000 was permitted to earn a return of less than 6% last year on the value of its property and equipment used by the public. In a year of unprecedented activity and unparalleled general prosperity, such a meager return to our railroads shows most convincingly the need for relief.

The Return on Property

During the eight years, 1907 to 1915, about $5,045,812,000 was added to capital and $32,731,000 less net income was earned in 1915 than in 1907.

Five thousand millions of new capital put in the railroads of the United States yielded thirty-three millions less than no return, and the return on the total capital in railroads fell from 4.73% for 1907, to 3.44% in 1915!

A clear picture of the situation is given in figures just compiled for the Eastern Railroads, comprising all roads east of the Mississippi and north of the Ohio and Potomac rivers, and carrying 45% of the traffic of the country.

Figures of Eastern Lines

Freight traffic of these Eastern carriers has increased 2½ times as fast as the population in the past 13 years, but the miles of line have increased only one-third as fast as the population. It has been only by intensive development of existing systems that the carriers have been able to keep pace with the demand for transportation. Since 1903 the average tractive power of locomotives has been increased by 50%, the average capacity of freight cars by 40%, and the average freight train load by 72%.

Meanwhile, with practically fixed rates for service and steadily increasing costs of operation, the return on property investment (amount available for interest, dividends and surplus), has been declining. This income averaged: 1903-1907, 5.87%; 1908-1912, 5.39%; and 1913-1916, 5.08%.

The figures show that with the diminishing return the flow of new capital into the railroad business has been checked. New investment in property from 1906 to 1911 was $1,133,000,000, an increase of 23%; but in the past five years (1911-1916) the new investment was only $756,000,000, an increase of but 12.5%.

If the capital stock of all the Eastern roads were disregarded, the income of the roads on their bonds for the past five years would be only 8.4%; and even in the "fat" year 1916, the big earnings show only about 11% on the bonds.

In the face of such facts, it is not possible to obtain the capital necessary for growth and development of transportation coextensive with the country's business expansion.

The railroads neared the peak of their earning power with their present facilities last year, and unless important additions to equipment, terminals, etc., are made, the cost of transportation will probably increase in a rapid ratio.

How to Solve the Problem

What is demanded primarily as a fundamental solution of the difficulties of the situation is a sane, efficient system of regulation under one responsible authority removed as far as possible from political considerations. Obviously, that authority must be the Federal Government. Exercising jurisdiction over more than 80% of the nation's commerce—the estimated bulk of interstate traffic—it is illogical and indefensible to maintain 48 additional "regulators" for the small remainder.

Before the Joint Congressional Committee of Inquiry, which is investigating the whole transportation problem, the railroads, through their executives, have offered the following suggestions for meeting the situation:

First: Federal supervision of railroad securities.

Second: Federal incorporation of interstate carriers.

Third: Federal regulation of rates.

Fourth: A regional and functional division of the work of the Interstate Commerce Commission.

Fifth: Restriction of rate suspensions to not more than sixty days.

Sixth: Giving the Interstate Commerce Commission power to prescribe minimum as well as maximum rates.

It is the belief of the railroad executives that, if they can be relieved of the conflicting, wasteful, and inefficient regulation of forty-eight States and the Federal body, and if this regulation can be unified under one head, with regional subdivisions, a great part of their present difficulty will be removed. Upon this platform the railroads have taken their stand and ask for public cooperation, not in *their* own interest, but in the *public* interest, because the business of this country can prosper only as it is adequately served by efficient transportation.

Immediate Remedies

Railroad economy and efficiency, under most exacting and embarrassing conditions, have accomplished such surprising results, that still greater advancement might be expected under the encouragement of fair and reasonable regulation.

Constructive suggestions which may be offered to relieve the railroad situation immediately and which, if adopted, promise a better day for the railroads than they have seen within a decade, may then be briefly summed up as follows:

First:. Increased rates.

Second: Federal regulation of rates and security issues.

Third: A larger Interstate Commerce Commission with regional and functional divisions.

Fourth Cooperation on the part of legislative, regulating and shipping interests to protect railroad credit and to further railroad expansion.

Fifth: Cooperation of investors to protect and maintain railroad credit.

Sixth: Recognition of our national unity of interest in a fundamental economic problem.

These are all obviously possible, and if provided would give a great impetus not only to the railroads but to business generally.

The Public Interest

It is this intimate connection between the railroad business and other forms of business which must be emphasized. The attitude of the American people toward their railroads as a whole for the past ten years has been one of detached criticism and punitive legislation. They have treated the railroad interests as though they were something apart, from which the last possible ounce of service at the lowest possible cost might properly be wrung. Their eyes have been focused solely upon their immediate selfish interest. This policy could have but one effect, which is now glaringly apparent. Yet "transportation is the one common interest of our industrial life," while railroad securities are the very heart of our whole American investment structure. Our existence as a nation may well be said to depend upon the efficiency of our railroads and the maintenance of their credit.

The great magnitude of the interests involved may appear when it is realized that over 50,000,000 of our people are directly and vitally interested in the prosperity of our railroads. They furnish a direct livelihood for over 9,000,000 people, and are a source of income for over 600,000 stockholders and 200,000 bondholders. Industries dependent upon the railroad business employ 5,000,000 more people, while the security of 30,000,000 insurance policy holders and 11,000,000 savings bank depositors is dependent largely upon railroad earnings.

It is conservatively estimated that more than $1,000,000,000 a year in new money must be put into the transportation system of the country in order to meet its pressing needs. This money must be raised through the sale of new securities. In order to be assured a market under the severe competition now existing for investment funds, the earning power and stability of railroad investments must be firmly established.

The solution to the problem is offered in the continuation of private ownership and

operation, properly regulated and protected. It may confidently be expected that the American people with their long record of constructive achievement, will deal with the subject as decisively and constructively as they have with economic questions of similar magnitude in the past.

The keynote of the hour is national unity. In unity of interest and spirit the railroad situation must be approached by representatives of all classes and sections in order that this fundamental economic problem, in which the prosperity of all is involved, may be solved along right lines, in fairness to all, for the common good.

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